ADVANCED DRAINAGE SYSTEMS, INC.
Form 10-Q
August 03, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number: 001-36557

ADVANCED DRAINAGE SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	51-0105665
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

4640 Trueman Boulevard, Hilliard, Ohio 43026

(Address of Principal Executive Offices, Including Zip Code)

(614) 658-0050

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," and "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer	Accelerated Filer
Non-Accelerated Filer	Smaller Reporting Company
Emerging Growth Company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of July 31, 2017, the registrant had 55,246,148 shares of common stock outstanding. The shares of common stock trade on the New York Stock Exchange under the ticker symbol "WMS". In addition, as of July 31, 2017, 242,020 shares of unvested restricted common stock were outstanding and 23,868,555 shares of ESOP, preferred stock, convertible into 18,359,692 shares of common stock, were outstanding. As of July 31, 2017, 73,847,860 shares of common stock were outstanding, inclusive of outstanding shares of unvested restricted common stock and on an as-converted basis with respect to the outstanding shares of ESOP preferred stock.

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PART I. FINANCIAL INFORMATION

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited) (In thousands, except par value)

	June 30, 2017	March 31, 2017
ASSETS		
Current assets:		
Cash	$8,717	$6,450
Receivables (less allowance for doubtful accounts of $10,377 and $10,431, respectively)	215,432	168,943
Inventories	262,188	258,430
Other current assets	9,512	6,743
Total current assets	495,849	440,566
Property, plant and equipment, net	417,635	406,858
Other assets:		
Goodwill	100,860	100,566
Intangible assets, net	50,125	51,758
Other assets	48,860	46,537
Total assets	$1,113,329	$1,046,285
LIABILITIES, MEZZANINE EQUITY AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Current maturities of debt obligations	$27,301	$37,789
Current maturities of capital lease obligations	21,946	21,450
Accounts payable	107,131	121,922
Current portion of liability-classified stock-based awards	—	11,926
Other accrued liabilities	59,523	54,460
Accrued income taxes	12,910	8,207
Total current liabilities	228,811	255,754
Long-term debt obligations (less unamortized debt issuance costs of $3,609 and $1,723, respectively)	377,712	310,849
Long-term capital lease obligations	61,521	58,710
Deferred tax liabilities	43,753	44,007
Other liabilities	23,484	26,530
Total liabilities	735,281	695,850
Commitments and contingencies (see Note 8)		
Mezzanine equity:		
Redeemable convertible preferred stock: $0.01 par value; 47,070 shares authorized; 44,170 shares issued; 23,868 and 24,225 shares outstanding, respectively	298,357	302,814
Deferred compensation – unearned ESOP shares	(196,204)	(198,216)

Redeemable noncontrolling interest in subsidiaries	8,431	8,227
Total mezzanine equity	110,584	112,825
Stockholders' equity:		
Common stock; $0.01 par value: 1,000,000 shares authorized; 153,560 shares issued; 55,246 and 55,338 shares outstanding, respectively	12,393	12,393
Paid-in capital	774,874	755,787
Common stock in treasury, at cost	(443,561)	(436,984)
Accumulated other comprehensive loss	(22,239)	(24,815)
Retained deficit	(70,289)	(83,678)
Total ADS stockholders' equity	251,178	222,703
Noncontrolling interest in subsidiaries	16,286	14,907
Total stockholders' equity	267,464	237,610
Total liabilities, mezzanine equity and stockholders' equity	$1,113,329	$1,046,285

See accompanying Notes to Condensed Consolidated Financial Statements.

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ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited) (In thousands, except per share data)

	Three Months Ended June 30,	
	2017	2016
Net sales	$358,359	$357,576
Cost of goods sold	271,620	260,970
Gross profit	86,739	96,606
Operating expenses:		
Selling	23,099	24,230
General and administrative	26,676	34,529
Loss on disposal of assets and costs from exit and disposal activities	3,423	202
Intangible amortization	2,044	2,187
Income from operations	31,497	35,458
Other expense:		
Interest expense	4,479	4,784
Derivative gains and other income, net	(954)	(3,037)
Income before income taxes	27,972	33,711
Income tax expense	9,746	14,194
Equity in net (income) loss of unconsolidated affiliates	(248)	96
Net income	18,474	19,421
Less: net income attributable to noncontrolling interest	732	1,148
Net income attributable to ADS	17,742	18,273
Accretion of redeemable noncontrolling interest	—	(362)
Dividends to redeemable convertible preferred stockholders	(489)	(425)
Dividends paid to unvested restricted stockholders	(19)	(30)
Net income available to common stockholders and participating securities	17,234	17,456
Undistributed income allocated to participating securities	(1,429)	(1,524)
Net income available to common stockholders	$15,805	$15,932
Weighted average common shares outstanding:		
Basic	55,303	54,071
Diluted	56,010	54,928
Net income per share:		
Basic	$0.29	$0.29
Diluted	$0.28	$0.29
Cash dividends declared per share	$0.07	$0.06

See accompanying Notes to Condensed Consolidated Financial Statements.

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ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited) (In thousands)

	Three Months Ended	
	June 30,	
	2017	2016
Net income	$18,474	$19,421
Currency translation	3,427	(3,121)
Comprehensive income	21,901	16,300
Less: other comprehensive income (loss) attributable to noncontrolling interest, net of tax	851	(1,501)
Less: net income attributable to noncontrolling interest	732	1,148
Total comprehensive income attributable to ADS	$20,318	$16,653

See accompanying Notes to Condensed Consolidated Financial Statements.

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ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited) (In thousands)

	Three Months Ended	
	June 30,	
	2017	2016
Cash Flows from Operating Activities		
Net income	$18,474	$19,421
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	18,221	18,026
Deferred income taxes	(281)	(745)
Loss on disposal of assets and costs from exit and disposal activities	3,423	237
ESOP and stock-based compensation	4,304	11,757
Amortization of deferred financing charges	353	341
Fair market value adjustments to derivatives	191	(4,907)
Equity in net (income) loss of unconsolidated affiliates	(248)	96
Other operating activities	(1,656)	293
Changes in working capital:		
Receivables	(47,469)	(24,858)
Inventories	(2,445)	(9,276)
Prepaid expenses and other current assets	(2,547)	(4,317)
Accounts payable, accrued expenses, and other liabilities	(6,857)	(6,200)
Net cash used in operating activities	(16,537)	(132)
Cash Flows from Investing Activities		
Capital expenditures	(17,949)	(12,595)
Other investing activities	(254)	(200)
Net cash used in investing activities	(18,203)	(12,795)
Cash Flows from Financing Activities		
Proceeds from Revolving Credit Facility	212,950	114,000
Payments on Revolving Credit Facility	(155,750)	(88,700)
Payments on Term Loan	(72,500)	(2,500)
Proceeds from Senior Notes	75,000	—
Debt issuance costs	(2,268)	—
Payments of notes, mortgages and other debt	(1,225)	(215)
Payments on capital lease obligations	(6,066)	(5,358)
Cash dividends paid	(4,353)	(3,665)
Proceeds from exercise of stock options	6	2,648
Repurchase of common stock	(7,947)	—
Other financing activities	(652)	(8)
Net cash provided by financing activities	37,195	16,202
Effect of exchange rate changes on cash	(188)	(662)

Net change in cash	2,267	2,613
Cash at beginning of period	6,450	6,555
Cash at end of period	$8,717	$9,168
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid for income taxes	$5,899	$2,229
Cash paid for interest	4,498	4,996
Non-cash operating, investing and financing activities:		
Acquisition of property, plant and equipment under capital lease and incurred lease obligations	9,588	13,450
Balance in accounts payable for the acquisition of property, plant and equipment	2,593	2,255

See accompanying Notes to Condensed Consolidated Financial Statements.

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ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS’ EQUITY AND MEZZANINE EQUITY

(Unaudited) (In thousands)

mon t s	Amount	Paid -In Capital	Common Stock in Treasury Shares	Amount	Accumu- lated Other Compre- hensive Loss	Retained Deficit	Total ADS Stock- holders’ Equity	Non- controlling Interest in Subsidiaries	Total Stock- holders’ Equity	Redeemable Convertible Preferred Stock Shares	Amount	Deferred Compensation - Unearned ESOP Shares Shares	Amou
560	$12,393	$739,097	99,123	$(440,995)	$(21,261)	$(101,778)	$187,456	$15,033	$202,489	24,819	$310,240	16,448	$(205,
	—	—	—	—	—	18,273	18,273	887	19,160	—	—	—	—
	—	—	—	—	(1,620)	—	(1,620)	(1,501)	(3,121)	—	—	—	—
	—	—	—	—	—	(386)	(386)	—	(386)	—	—	—	—
	—	—	—	—	—	(3,279)	(3,279)	—	(3,279)	—	—	—	—
	—	909	—	—	—	—	909	—	909	—	—	(146)	1,828
	—	4,274	(232)	1,032	—	—	5,306	—	5,306	—	—	—	—
	—	17	(47)	207	—	—	224	—	224	—	—	—	—
	—	1,980	(168)	747	—	—	2,727	—	2,727	(218)	(2,727)	—	—

	—	(223)	—	—	—	—	(223)	—	(223)	—	—	—	—
560	$12,393	$746,054	98,676	$(439,009)	$(22,881)	$(87,170)	$209,387	$14,419	$223,806	24,601	$307,513	16,302	$(203.
560	$12,393	$755,787	98,222	$(436,984)	$(24,815)	$(83,678)	$222,703	$14,907	$237,610	24,225	$302,814	15,863	$(198.
	—	—	—	—	—	17,742	17,742	528	18,270	—	—	—	—
	—	—	—	—	2,576	—	2,576	851	3,427	—	—	—	—
	—	—	—	—	—	(458)	(458)	—	(458)	—	—	—	—
	—	—	—	—	—	(3,895)	(3,895)	—	(3,895)	—	—	—	—
	—	602	—	—	—	—	602	—	602	—	—	(161)	2,012
	—	3	(1)	3	—	—	6	—	6	—	—	—	—
	—	447	(33)	147	—	—	594	—	594	—	—	—	—
	—	13,714	—	—	—	—	13,714	—	13,714	—	—	—	—
	—	1,084	—	—	—	—	1,084	—	1,084	—	—	—	—
	—	3,237	(274)	1,220	—	—	4,457	—	4,457	(357)	(4,457)	—	—
	—	—	400	(7,947)	—	—	(7,947)	—	(7,947)	—	—	—	—

560	$12,393	$774,874	98,314	$(443,561)	$(22,239)	$(70,289)	$251,178	$16,286	$267,464	23,868	$298,357	15,702	$(196,

See accompanying Notes to Condensed Consolidated Financial Statements.

Advanced Drainage Systems, Inc.

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business – Advanced Drainage Systems, Inc. and subsidiaries (collectively referred to as “ADS” or the “Company”), incorporated in Delaware, designs, manufactures and markets high performance thermoplastic corrugated pipe and related water management products, primarily in North and South America and Europe. ADS’s broad product line includes corrugated high density polyethylene (or “HDPE”) pipe, polypropylene (or “PP”) pipe and related water management products.

The Company is managed based primarily on the geographies in which it operates and reports results of operations in two reportable segments: Domestic and International.

Historically, sales of the Company’s products have been higher in the first and second quarters of each fiscal year due to favorable weather and longer daylight conditions accelerating construction activity during these periods. Seasonal variations in operating results may also be impacted by inclement weather conditions, such as cold or wet weather, which can delay projects.

Basis of Presentation – The Company prepares its Condensed Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The Condensed Consolidated Balance Sheet as of March 31, 2017 was derived from audited financial statements included in the Annual Report on Form 10-K for the year ended March 31, 2017 (“Fiscal 2017 Form 10-K”). The accompanying unaudited Condensed Consolidated Financial Statements contain all adjustments, of a normal recurring nature, necessary to present fairly its financial position as of June 30, 2017 and the results of operations and cash flows for the three months ended June 30, 2017 and 2016. The interim Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements, including the notes thereto, filed in the Company’s Fiscal 2017 Form 10-K.

Principles of Consolidation – The Condensed Consolidated Financial Statements include the Company, its wholly-owned subsidiaries, its majority-owned subsidiaries and variable interest entities (“VIEs”) of which the Company is the primary beneficiary. The Company uses the equity method of accounting for equity investments where it exercises significant influence but does not hold a controlling financial interest. Such investments are recorded in Other assets in the Condensed Consolidated Balance Sheets and the related equity earnings from these investments are included in Equity in net loss (income) of unconsolidated affiliates in the Condensed Consolidated Statements of Operations. All intercompany balances and transactions have been eliminated in consolidation.

Recent Accounting Guidance

Recently Adopted Accounting Guidance

Measurement of Inventory – In July 2015, the Financial Accounting Standards Board (“FASB”) issued an accounting standards update (“ASU”) which requires entities to measure most inventory at the lower of cost and net realizable value, simplifying current guidance under which an entity must measure inventory at the lower of cost or market. The determination of market value, under current guidance, is considered unnecessarily complex as there are several potential outcomes based on its definition as replacement cost, net realizable value, or net realizable value less an approximate normal profit margin. Whereas net realizable value, under the update, is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. This update is effective for annual periods beginning on or after December 15, 2016, and interim periods within those years, with early adoption permitted. The Company adopted this standard effective April 1, 2017. The new standard did not have a material impact on the Condensed Consolidated Financial Statements.

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Advanced Drainage Systems, Inc.

Stock-Based Compensation – In March 2016, the FASB issued an ASU which is intended to simplify certain aspects of the accounting for stock-based compensation. The Company adopted the standard on April 1, 2017. The adoption of the ASU did not have a material impact on the historical consolidated financial statements. This update contains changes to the accounting for excess tax benefits, whereby excess tax benefits will be recognized in the income statement rather than in additional paid-in capital on the balance sheet. This update is expected to result in increased volatility to income tax expense in future periods dependent upon the timing of employee exercises of stock options, the price of the Company's common stock and the vesting of restricted stock awards. In addition, excess tax benefits will now be classified as operating cash flows rather than financing cash flows in the Consolidated Statements of Cash Flows.

The amendment also contains potential changes to the accounting for forfeitures, whereby entities can elect to either continue to apply the current requirement to estimate forfeitures when determining compensation expense, or to alternatively reverse the compensation expense of forfeited awards when they occur. The Company will account for forfeitures as they occur, which may result in expense volatility based on the timing of forfeitures.

In addition, the update also modified the net-share settlement liability classification exception for statutory income tax withholdings, whereby the new guidance allows an employer with a statutory income tax withholding obligation to withhold shares with a fair value up to the maximum statutory tax rate in the employee’s applicable jurisdiction. The Company included this provision in awards issued in fiscal 2017 and modified previously issued awards on April 1, 2017. See “Note 10. Stock-Based Compensation” for further information on the modification.

Definition of a Business – In January 2017, the FASB issued an ASU to clarify the definition of a business. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. The amendments are intended to help companies and other organizations evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments provide a more robust framework to use in determining when a set of assets and activities is a business. The amendments are effective for annual periods beginning after December 15, 2017, including interim periods within those periods. The Company adopted this standard effective April 1, 2018. The new standard did not have a material impact on the Condensed Consolidated Financial Statements.

Recent Accounting Guidance Not Yet Adopted

Revenue Recognition – In May 2014, the FASB issued an ASU which amends the guidance for revenue recognition. This standard contains principles that will require an entity to recognize revenue to depict the transfer of goods and services to customers at an amount that an entity expects to be entitled to in exchange for goods or services. The standard sets forth a new revenue recognition model that requires identifying the contract, identifying the performance obligations and recognizing the revenue upon satisfaction of performance obligations. In August 2015, the FASB issued an ASU that deferred the effective date of the new revenue standard for public entities to periods beginning after December 15, 2017, with early adoption permitted but not earlier than the original effective date of periods beginning after December 15, 2016. There have also been various additional accounting standards updates issued by the FASB in 2016 that further amend this new revenue standard. The updated standard permits the use of either the retrospective or cumulative effect transition method. The Company expects to adopt this standard effective April 1, 2018. The Company has not yet selected a transition method and is currently evaluating the impact of this standard on the consolidated financial statements.

Leases – In February 2016, the FASB issued an ASU which amends the guidance for leases. This standard contains principles that will require an entity to recognize most leases on the balance sheet by recording a right-of-use asset and a lease liability, unless the lease is a short-term lease that has an accounting lease term of twelve months or less. The standard also contains other changes to the current lease guidance that may result in changes to how entities determine which contractual arrangements qualify as a lease, the accounting for executory costs such as property taxes and insurance, as well as which lease origination costs will be capitalizable. The new standard also requires expanded quantitative and qualitative disclosures. This standard

Advanced Drainage Systems, Inc.

is effective for fiscal years beginning after December 15, 2018, including interim periods within those years, and early adoption is permitted. The standard requires the use of the modified retrospective transition method, whereby the new guidance will be applied at the beginning of the earliest period presented in the financial statements of the period of adoption. The modified retrospective transition approach includes certain practical expedients that entities may elect to apply in transition. The Company expects to adopt this standard effective April 1, 2019. The Company has not yet determined whether to apply any of the available practical expedients. The Company has begun the process of reviewing contracts under the new standard to determine the impact the new standard will have on the consolidated financial statements. The Company is also in process of implementing a new software solution to improve the process of accounting for leases under the current and new standard.

Measurement of Credit Losses – In June 2016, the FASB issued an ASU which provides amended guidance on the measurement of credit losses on financial instruments, including trade receivables. This standard requires the use of an impairment model referred to as the current expected credit loss model. This standard is effective for fiscal years beginning after December 15, 2019, including interim periods within those years, and early adoption is permitted for fiscal years beginning after December 15, 2018. The Company expects to adopt this standard effective April 1, 2020. The Company is currently evaluating the impact of this standard on the consolidated financial statements.

Cash Flow Classification – In August 2016, the FASB issued an ASU which provides amended guidance on the classification of certain cash receipts and cash payments in the statement of cash flows, including related to debt prepayment or debt extinguishment costs, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance and distributions received from equity method investees. This update is effective for fiscal years beginning after December 15, 2017, including interim periods within those years, and early adoption is permitted. This amended guidance must be applied retrospectively to all periods presented, but may be applied prospectively if retrospective application would be impracticable. The Company expects to adopt this update effective April 1, 2018. The Company is currently evaluating the impact of this update on the consolidated financial statements.

Goodwill Impairment – In January 2017, the FASB issued an ASU which removes the requirement to compare the implied fair value of goodwill with its carrying amount as part of step 2 of the goodwill impairment test. As a result, under the standards update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The amendments are effect for annual periods beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company expects to adopt this standard effective April 1, 2020. The Company is currently evaluating the impact of this standard on the consolidated financial statements.

Stock-Based Compensation – In May 2017, the FASB issued an ASU to clarify when modification accounting should be applied for changes to the terms or conditions of share-based payment awards. The amendments clarify that modification accounting guidance should only be applied if there is a change to the value, vesting conditions, or award classification and would not be required if the changes are considered non-substantive. The amendments are effective for annual periods beginning after December 15, 2017, including interim periods within those periods. The Company expects to adopt this standard effective April 1, 2018. The Company is currently evaluating the impact of this update on its consolidated financial statements.

With the exception of the pronouncements described above, there have been no new accounting pronouncements issued or adopted since the filing of the Fiscal 2017 Form 10-K that have significance, or potential significance, to the Condensed Consolidated Financial Statements.

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Advanced Drainage Systems, Inc.

2. LOSS ON DISPOSAL OF ASSETS AND COSTS FROM EXIT AND DISPOSAL ACTIVITIES

The Company recorded loss on disposal of assets and costs from exit and disposal activities of $3.4 million and $0.2 million for the three months ended June 30, 2017 and 2016, respectively.

The Company recorded $2.6 million of expenses related to two manufacturing facilities closing in fiscal 2018. The expenses include approximately $2.0 million in accelerated depreciation and $0.6 million of severance. An additional $0.8 million loss on other disposals and partial disposals of property, plant and equipment was recorded.

3. INVENTORIES

Inventories as of the periods presented consisted of the following:

	June 30, 2017	March 31, 2017
	(In thousands)	
Raw materials	$57,834	$ 52,746
Finished goods	204,354	205,684
Total inventories	$262,188	$ 258,430

There were no work-in-process inventories as of the periods presented.

4. FAIR VALUE MEASUREMENT

When applying fair value principles in the valuation of assets and liabilities, the Company is required to maximize the use of quoted market prices and minimize the use of unobservable inputs. The Company has not changed its valuation techniques used in measuring the fair value of any financial assets or liabilities during the fiscal years presented. The fair value estimates take into consideration the credit risk of both the Company and its counterparties.

When active market quotes are not available for financial assets and liabilities, ADS uses industry standard valuation models. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including credit risk, interest rate curves, foreign currency rates and forward and spot prices for currencies. In circumstances where market-based observable inputs are not available, management judgment is used to develop assumptions to estimate fair value. Generally, the fair value of Level 3 instruments is estimated as the net present value of expected future cash flows based on internal and external inputs.

Recurring Fair Value Measurements - The assets and liabilities carried at fair value as of the periods presented were as follows:

	June 30, 2017
	Total

		Level 1	Level 2	Level 3
	(In thousands)			
Assets:				
Derivative assets – diesel fuel contracts	$38	$ —	$38	$—
Derivative assets – interest rate swap	547	—	547	—
Total assets at fair value on a recurring basis	$585	$ —	$585	$—
Liabilities:				
Derivative liability - diesel fuel contracts	$277	$ —	$277	$—
Derivative liability - interest rate swap	462	—	462	—
Contingent consideration for acquisitions	858	—	—	858
Total liabilities at fair value on a recurring basis	$1,597	$ —	$739	$858

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Advanced Drainage Systems, Inc.

	March 31, 2017			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Assets:				
Derivative assets – diesel fuel contracts	$179	$ —	$179	$—
Total assets at fair value on a recurring basis	$179	$ —	$179	$—
Liabilities:				
Derivative liability - diesel fuel contracts	$142	$ —	$142	$—
Contingent consideration for acquisitions	1,348	—	—	1,348
Total liabilities at fair value on a recurring basis	$1,490	$ —	$142	$1,348

For the three months ended June 30, 2017 and 2016, respectively, there were no transfers in or out of Levels 1, 2 or 3.

Valuation of Contingent Consideration for Acquisitions - The fair values of the contingent consideration payables for acquisitions were calculated based on a discounted cash flow model, whereby the probability-weighted future payment value is discounted to the present value using a market discount rate. The method used to price these liabilities is considered Level 3, due to the subjective nature of the unobservable inputs used to determine the fair value. Changes in the fair value of recurring fair value measurements using significant unobservable inputs (Level 3) for the periods presented were as follows:

	Three Months ended June 30,	
	2017	2016
	(In thousands)	
Balance at the beginning of the period	$1,348	$2,858
Change in fair value	26	24
Payments of contingent consideration liability	(516)	(683)
Balance at the end of the period	$858	$2,199

Valuation of Debt - The carrying amounts of current financial assets and liabilities approximate fair value because of the immediate or short-term maturity of these items, or in the case of derivative instruments, because they are recorded at fair value. The carrying and fair value of the Company’s Senior Notes (discussed in “Note 6. Debt”) were $150.0 million and $150.3 million, respectively, as of June 30, 2017 and $75.0 million and $75.9 million, respectively, at March 31, 2017. The fair value of the Senior Notes was determined based on a comparison of the interest rate and terms of such borrowings to the rates and terms of similar debt available for the period. The Company believes the carrying amount on the remaining long-term debt, including the Secured Bank Term Loans, is not materially different from its fair value as the interest rates and terms of the borrowings are similar to currently available borrowings. The categorization of the framework used to evaluate this debt is considered Level 2.

5. RELATED PARTY TRANSACTIONS

ADS Mexicana - ADS conducts business in Mexico and Central America through its joint venture ADS Mexicana, S.A. de C.V. (together with its affiliate ADS Corporativo, S.A. de C.V., “ADS Mexicana”). ADS owns 51% of the outstanding stock of ADS Mexicana and consolidates ADS Mexicana for financial reporting purposes. During the three months ended June 30, 2017 and 2016, ADS Mexicana compensated certain current and former shareholders of Grupo Altima, the joint venture partner of ADS Mexicana, for consulting services related to the operations of the business. These cash payments were less than $0.1 million for the three months ended June 30, 2017 and 2016.

Occasionally, ADS and ADS Mexicana jointly enter into agreements for pipe sales with related parties. There were no such sales in either the three months ended June 30, 2017 and 2016. However, outstanding

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receivables related to such sales from prior periods were $0.2 million as of both June 30, 2017 and March 31, 2017.

The Company is the guarantor of 100% of a second credit facility for ADS Mexicana, and the Company's maximum potential payment under this guarantee is $12.0 million. See "Note 6. Debt."

South American Joint Venture - The Tuberias Tigre – ADS Limitada joint venture (the "South American Joint Venture") manufactures and sells HDPE corrugated pipe in certain South American markets. ADS is the guarantor for 50% of the South American Joint Venture's credit facility, and the debt guarantee is shared equally with the joint venture partner. The Company's maximum potential obligation under this guarantee totals $11.0 million as of June 30, 2017. The maximum borrowings permitted under the South American Joint Venture's credit facility are $22.0 million. This credit facility allows borrowings in either Chilean pesos or US dollars at a fixed interest rate determined at inception of each draw on the facility. The guarantee of the South American Joint Venture's debt expires on December 31, 2020. ADS does not anticipate any required contributions related to the balance of this credit facility. As of June 30, 2017 and March 31, 2017, the outstanding principal balances of the credit facility including letters of credit were $15.4 million and $16.0 million, respectively. As of June 30, 2017, there were no U.S. dollar denominated loans. The weighted average interest rate as of June 30, 2017 was 6.0% on Chilean peso denominated loans.

ADS and the South American Joint Venture have shared services arrangements in order to execute the joint venture services. In addition, the South American Joint Venture has entered into agreements for pipe sales with ADS and its other related parties, which totaled $0.6 million and $0.2 million for the three months ended June 30, 2017 and 2016, respectively. ADS pipe sales to the South American Joint Venture were less than $0.1 million and $0.3 million in the three months ended June 30, 2017 and 2016.

BaySaver - BaySaver Technologies LLC ("BaySaver") is a joint venture that was established to produce and distribute water quality filters and separators used in the removal of sediment and pollution from storm water. ADS owns 65% of the outstanding stock of BaySaver and consolidates its interest in BaySaver.

ADS and BaySaver have entered into shared services arrangements in order to execute the joint venture services. Included within these arrangements are the lease of a plant and adjacent yard used to conduct business and operating expenses related to the leased facility. Occasionally, ADS and BaySaver jointly enter into agreements for sales of pipe and Allied Products with their related parties, which were less than $0.1 million for the periods presented.

Tigre-ADS USA - Tigre-ADS USA is a joint venture established to manufacture and sell PVC fittings for waterworks, plumbing, and HVAC applications primarily in the United States and Canadian markets. ADS owns 49% of the outstanding shares of capital stock of Tigre-ADS USA. The joint venture represents a continuation of the existing activities of Tigre-ADS USA through its Janesville, Wisconsin manufacturing facility.

ADS is the guarantor for 49% of a specific Tigre-ADS USA credit facility. The Company's maximum potential obligation under this guarantee totals $3.2 million as of June 30, 2017. The guarantee of Tigre-ADS USA's debt expires on October 11, 2017. ADS does not anticipate any required contributions related to the balance of this credit facility. The outstanding principal balance of the credit facility including letters of credit the Company guarantees was $6.5 million as of both June 30, 2017 and March 31, 2017. The weighted average interest rate as of June 30, 2017 was 3.85%.

ADS purchased $0.6 million and $0.4 million of Tigre-ADS USA manufactured products for use in the production of ADS products during the three months ended June 30, 2017 and 2016.

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6. DEBT

Long-term debt as of the periods presented consisted of the following:

	June 30, 2017	March 31, 2017
	(In thousands)	
Secured Bank Term Loans:		
Revolving Credit Facility — ADS	$252,500	$ 194,300
Revolving Credit Facility — ADS Mexicana	500	1,500
Term Note	—	72,500
Senior Notes payable	150,000	75,000
Industrial revenue bonds	1,620	1,845
Equipment financing	4,002	4,216
ADS Mexicana Scotia bank revolving credit facility	—	1,000
Total	408,622	350,361
Unamortized debt issuance costs	(3,609)	